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IN THE

Supreme Court of the United States

October Term, 1935

No. 270

THE PRUDENCE COMPANY, INC.,

Petitioner

v.

FIDELITY & DEPOSIT COMPANY OF MARYLAND and AMERICAN BONDING COMPANY OF BALTIMORE

PETITIONER'S REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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The grounds for petitioner's recovery of interest, taxes and insurance premiums as part of the damages under the surety bond, are threefold:

1. Interest, taxes and insurance premiums are recoverable as a part of the damages contemplated when the surety bond—guaranteeing not only completion of the building but performance of the building loan agreement—was executed and delivered. *Trainor* v. *Aetna Casualty Company* and *Kidd* v. *McCormick* by their language conclusively show that these items are within the contemplation of the parties when a surety bond of the nature of the one in this case, is delivered.

2. Such items are necessarily included in the difference between the value of the property, as of the date on which the building was to have been completed, and the value of the property with the building fully completed, as guaranteed, because necessarily a willing buyer would deduct from any price he otherwise would pay not only the cost of labor and materials necessary to complete the building up to the mark of the contract, but also the taxes and insurance he would be required to pay during completion and the interest during the period of completion on the amount so paid. In other words, such items constitute part of the "cost of completion."

3. Under the terms of the particular agreements here involved, defendants have by their surety bond expressly bound themselves, even apart from the general principles of law above mentioned, to pay interest, taxes and insurance premiums up to and including completion of the building.

All three of the above grounds for sustaining the judgment of the District Court were argued below, respondents' claims (Brief, p. 18) to the contrary notwithstanding.

With Reference to Respondents' Supplementary Statement of Facts

At the outset, it is necessary to correct several of the statements in the supplementary statement of facts in respondents' brief:

1. The attempt by respondents to narrow the effect of the surety bond in this case by calling it a completion bond, while all too obvious in purpose, cannot succeed, in view of the very broad and inclusive terms of the bond itself, which guaranteed not only completion of the building but also performance of all the provisions of the building loan agreement, *including* the provision for payment of interest on the bond and mortgage up to the completion of the building.

Respondents' statement at the top of page 2 that

> "nowhere in respondents' bond is there any provision guaranteeing performance of the provisions of the bond and mortgage".

is flatly contrary to the express provision of the bond which is that

> "said Surety * * * shall make good any and every other default by the Principal in performing any of the other terms, covenants or conditions in said building loan agreement set forth, by the Principal to be kept and performed up to and including the completion of and payment for said building" (R. p. 596)

and the provision of the building loan agreement which was made part of the bond that

> "interest on the full principal amount shall run from the date herein fixed for completion * * *. The provisions of this paragraph shall not relieve the Borrower from the obligation to pay interest on the quarter annual dates" (R. p. 570).

and the further covenant of the building loan agreement wherein the Principal agreed to

> "perform and comply with all and every of the covenants, terms and conditions herein *and in said bond and mortgage* contained" (R. p. 568)—

and that bond and mortgage did contain an express covenant to pay interest (see subdivision "Third" of Building Loan Agreement, R. p. 570).

Aside from the obligations expressly contained in the surety bond, that surety bond and the building loan agreement which was made a part of it are implicit with the intention—and, therefore, it was within the contemplation of the parties—that a building "ready for occupancy" was to be security for the building loan.

Respondents' brief does not dispute the defaults under the building loan agreement, the expenditures made by The Prudence Company, Inc. (including expenses for taxes and insurance premiums), the existence of the omissions and substitutions complained of, nor the fact that the Prudence Company, Inc. received no interest on its loan of over Six Million Dollars subsequent to December 16, 1930.

2. The bond of Mr. Lefcourt (Ex. 10) is not comparable with the respondents' surety bond. It expired according to its terms *before* the date on which the building was to have been completed, or the maturity of the mortgage. Respondents neglect to quote the provision (R. p. 681) that the obligation under the guarantee should cease on the issuance of the "customary certificates of occupancy," which are not certificates of completion (R. p. 494), and which were issued in October, 1930 (R. pp. 79, 712).

3. Respondents' statement (their brief, p. 2) that there was no evidence of what would have been a reason-

able time within which to complete the building is altogether unjustified. Petitioner did prove that the time taken for completion was reasonable.

When petitioner's witness, Mr. Lukach, testified that he was there every day and every hour of every day (R. p. 237), and that the cost of completion as set forth in Exhibit 84 was the reasonable cost of completion (R. p. 233), he covered every possible question there could be concerning the time necessary for the completion. The time necessary for completion is an inherent element of the cost of completion, and testimony of the reasonable cost of completion necessarily includes the fact that the time required for completion was entirely reasonable. Especially in this so here, because the payrolls which were included in the cost of completion (Ex. 84, at R. p. 761) necessarily involved the question of time. Labor cannot be considered apart from the element of time.

As against the actual facts and the actual time taken for completion, respondents now refer only to the testimony of the witness Banfield that, in his opinion, it would have taken between four and eight weeks to complete the different items listed on Schedule A (Ex. 84, R. p. 436). The fact is, however, that Mr. Banfield admitted (R. p. 370) that he had not gone over the plans and specifications and had not made a thorough study. He, of course, could not have had in mind the special difficulties inherent in picking up a job abandoned by the builder.

The District Court was perfectly justified in refusing to give any weight to such a rough off-hand estimate of Mr. Banfield.

At the most, therefore, respondents' statement repeats a contention of fact on which the weight of evidence was against them, and the finding of fact of the trial Judge was conclusive.

4. The allegation that petitioner lost no interest after its dummy bought in the premises at the foreclosure sale almost answers itself. Admittedly, petitioner still received no interest and—so far from getting any return on its investment of $6,575,000—was compelled to continue expenditures on the completion of the building.

5. Another incorrect statement appears on page 20 of respondents' brief, where they would make it appear that the liens against which the bond provided were restricted to mechanics' liens, and therefore could not include taxes. The provision cited and relied on by petitioner is not that quoted at page 20 of respondents' brief from page 596 of the Record, but rather the covenant in the building loan agreement (R. p. 568) that plaintiff's mortgage, as stated at page 29 of our brief, was to be a "valid first lien upon the premises," "free and clear of all liens and encumbrances."

6. It cannot be gainsaid that plaintiff in its complaint specifically claimed interest, taxes and insurance premiums as part of the damages, in the same paragraph and the same list as the cost of labor and materials and the other items were claimed. This action and the defendants' liability are predicated on the surety bond and the building loan agreement, which by stipulation (R. p. 520b) were part of the pleadings on the preliminary motions addressed to the sufficiency of the answers of the defendants.

7. Respondents have failed to state that the deficiency judgment which was entered April 3 (should be April 30), 1931 (R. p. 20) was for $716,215.02 which, with interest from April 30, 1931, is more than the amount of the judgment obtained by plaintiff in this case. Respondents have

also failed to state that the purchaser on the foreclosure sale in which the deficiency judgment was entered, was James T. Harrigan, who "represented and was a nominee of, this plaintiff." (See the allegation of complaint, R. p. 20—the same page as respondents have cited—which allegation of the complaint was expressly offered in evidence by the respondents themselves, R. p. 314).

8. For respondents to state on page 4 that

> "As a matter of fact, petitioner did not lose interest on $6,000,000 between March 17, 1931 and October 1, 1931, because it sold the very same premises for $6,000,000 on March 17, 1931"

is a flat misstatement of fact in view of the *undisputed* fact in this case that the purchaser on the foreclosure sale on March 17, 1931 "represented and was a nominee of this plaintiff" (R. p. 20). The quotation last made is from subdivision marked "XXXIX" of the complaint which was offered in evidence by the respondents themselves on the trial (R. p. 314).

I

In Reply to Respondents' Point I

A (in Respondents' Brief)

The attempt by respondents to show that parts of the opinion of Mr. Justice SUTHERLAND in *Trainor* v. *Aetna Casualty Co.* were *dicta,* is tantamount to an admission by respondents that they believe that this Court's opinion in that case with respect to interest, taxes and insurance premiums is contrary to the contentions they are now advancing, and also that the Circuit Court of Appeals disregarded the opinion of this Court.

While this Court is better able than anyone else to discern *dicta,* we respectfully submit that under that part of the decision in the *Trainor* case which is quoted on pages 8 and 9 of respondents' brief, namely:

> "Petitioner is entitled to be put in as good position *in respect of its debt* as it would have occupied if the buildings had been completed in accordance with the terms of the undertaking; and this can be done *here* only by giving it the amount of the difference between the value of the unfinished buildings and their value as it would have been if completed in accordance with the agreement—see *Kidd* v. *McCormick, supra,* p. 398—but exceeding neither the amount due on its debt nor the amount of the bond"

petitioner is not "put in as good position *in respect of its debt* as it would have occupied if the building had been completed in accordance with the terms of the undertaking" unless petitioner recovers interest, taxes and insurance premiums during the period of completion.

Obviously, the income of the building was designed to be security for interest, taxes and insurance, and it is equally obvious that when the building was not completed, there was no income to cover interest, taxes and insurance.

Respondents would treat the position of the plaintiff in this case exactly the same as if there were no building on the property, which was the security for the mortgage, and would relegate petitioner to the same position as if it had a mortgage on unoccupied property.

The trial Court's interpretation of *Trainor* v. *Aetna Casualty Co.,* 290 U. S. 47, and *Kidd* v. *McCormick,* 83 N. Y. 391 (see respondents' brief, p. 8) shows what must have been the understanding and contemplation not only of courts but of sureties and builders dealing with them,

as to the meaning of those cases, namely, that interest, taxes and insurance premiums were part of the damages suffered by default under the building loan agreement.

The Circuit Court of Appeals, although quoting a part of this Court's opinion (see respondents' brief, p. 4), made no attempt to apply it to the facts of the instant case, or to explain why they refused to allow the very items of damages which this Court had stated should be taken into consideration. The cases cited at page 10 of respondents' brief do not disprove the right to interest, taxes and insurance premiums.

United Real Estate Co. v. *McDonald,* 140 Mo. 605, 612, was cited by the *plaintiff* in the *Trainor* case (brief in this Court, pp. 16, 17), only on the point of the difference between a bond of guaranty and a bond of indemnity. The bond here involved, as already set forth, is both a guaranty of completion and indemnity.

Province Securities Corp. v. *Maryland Casualty Co.,* 269 Mass. 75, was one of the cases cited by the *defendant* in the *Trainor* case, and which this Court refused to follow as contrary to the weight of authority and of reason.

Nor can respondents find any support for their argument in their claim with respect to the so-called "date of the default" because:

> 1. If December 16, 1930, the date on which the building was to be completed, is taken as the date of the default, plaintiff's loss on that day would be not only the cost of labor and material necessary for completion, and the reasonable value of omissions and substitutions, but also interest, taxes and insurance premiums during completion; or if the loss is to be computed on the basis of difference in value between the building as of December 16, 1930,

and what the building would have been worth had the building been completed up to the mark of the contract, one of the elements going into that difference in value would inevitably be the amount which a willing buyer would have to deduct from the price which he would otherwise pay for the property on December 16, 1930, in order to cover interest on his investment and taxes and insurance during the period of completion.

2. Those provisions of the surety bond in which the defendants agreed

> "to make good any and every other default by the Principal in performing any of the other terms, covenants or conditions in said building loan agreement set forth by the Principal to be kept and performed up to and including the completion of and payment for said building" (R. p. 596)

would carry the date of the default up to the completion of the building.

The fact that on December 16, interest, taxes and insurance premiums during completion would have to be estimated is no reason why they should not be included in the damages.

Under both the *Trainor* and *Kidd* cases, as well as the other authorities on the subject, the difference in value at the date of default may be shown by proving the cost "to complete the unfinished house up to the mark of the contract," whether it is actually completed or not. Petitioner's evidence was exactly within that rule.

B (in Respondents' Brief)

For respondents to argue that petitioner's loss of interest, taxes and insurance premiums was caused by the default of the mortgagor in paying the amounts due under the mortgage and not by failure to complete the building is not only a distinction without a difference, but also directly contrary to this Court's decision in the *Trainor* case, as well as directly contrary to the basic facts in this case.

Petitioner's loss was in not having a completed building on December 16, 1930.

Because petitioner did not have a completed building "ready for occupancy" (as required by the surety bond—R. p. 595—) petitioner was deprived of a source of income out of which it could recoup itself for interest, taxes and insurance premiums.

Moreover, when this Court said in the *Trainor* case:

> "Petitioner is entitled to be put in as good position *in respect of its debt* as it would have occupied if the buildings had been completed in accordance with the terms of the undertaking;"

this Court meant, we respectfully submit, that the loss of the security for the debt directly affected the petitioner *in respect of its debt.*

It follows, therefore, that failure to complete the building was the proximate cause of loss to the petitioner, because it was thereby deprived of a property out of which it could have derived an income for interest, taxes and insurance premiums.

It is sheer nonsense for a surety to argue that there is no connection between default on the building loan agreement and default on the mortgage (see Respondents'

Brief, pp. 12-13). The fact that the payment of the mortgage debt depends to a large extent upon the completion of a revenue producing building is the reason for and in fact the justification for a surety bond.

Respondents' statement on page 13 of their brief, that petitioner would not have received interest on its mortgage if the respondents had completed the building is difficult to understand and is belied by the fact that petitioner in this case refused to make the loan until it had respondents' bond, guaranteeing the completion of the building, from which it could derive an income sufficient to pay interest, taxes and insurance premiums (see our Main Brief, pp. 33-34).

C (in Respondents' Brief)

That one may be liable for the interest which his default prevents a party from obtaining on an independent contract and that interest as damages may be entirely separate and apart from interest on principal not only follows from the law with respect to contemplated damages, but also is adequately shown by *Meyer* v. *Haven*, 70 App. Div. 529, and the other authorities cited at page 28 of our brief, which respondents make no attempt to answer.

Hamilton v. *Van Rensselaer*, 43 N. Y. 244 (brief, p. 14) has no application here. That case held that a guaranty of interest did not without other words cover interest accruing after the maturity of the principal debt. Respondents' obligation in this case extends "up to and including the completion of and payment for said building" (R. p. 596-97), that is to October 1, 1931.

II

In Reply to Respondents' Point II

Respondents have failed to even attempt to answer, refer to or explain the specific provisions of their surety bond and the building loan agreement which we have cited by line and page in our brief.

This case does not require a decision whether the surety bond obligated the respondents to pay the principal due under the building loan agreement up to the amount of their bond. It is sufficient that (in addition to interest, taxes and insurance premiums being within the contemplation of the parties) the surety bond clearly *did* obligate respondents to pay interest on the amount advanced under the building loan up to the actual completion of the building "ready for occupancy as a modern hotel".

Nor can the respondents escape the specific provisions of their surety bond and the building loan agreement by any claim of a practical interpretation by the parties, because, obviously, no specific claim for interest, taxes and insurance premiums could be made until

> (1) it had first been determined whether the sureties themselves would complete the building and how long they would require
>
> and
>
> (2) the building had been completed and thus the amount of interest, taxes and insurance premiums definitely known.

Respondents cannot point to a single act of petitioner *after* the building had been completed, which in any way negatives petitioner's claim to interest, taxes and insur-

ance premiums. As we have stated, the default under the surety bond continued until after the building had been completed.

We have already fully answered respondents' claim (brief, p. 19) with respect to taxes (*supra*, p. 6).

We have also fully answered respondents' attempt to show that petitioner has discarded the argument made by the Trial Court for the inclusion of taxes and insurance premiums in the damages (*supra*, pp. 1-2).

Respondents' claim (p. 19) that paragraph Fourteenth of the building loan agreement "*simply* requires the borrower *to place* all insurance through a designated insurance broker" (R. pp. 580-581) (italics ours) is futile on its face.

Can anyone question the fact that when a person "places an order," such person obligates himself to pay therefor?

III

In Reply to Respondents' Point III

It is too well settled to admit of argument, we submit, that what parties contemplated as damages *is* a question of fact.

The question of rental value of the building was first injected into the case by the Circuit Court of Appeals (see Opinion, R. p. 884). We referred to it in our main brief on this application (pp. 33-34), for the purpose of showing that plaintiff was not seeking to recover *profits* equal to the possible rental value of the building, but only its *losses* as mortgagee (namely, taxes, interest and insurance), which the parties must have contemplated that the completed building, not only could, but would be able to pay out of its rentals.

IV

In Reply to Respondents' Point IV

A very simple analysis very clearly shows the error of the Circuit Court of Appeals and the fallacy of respondents' argument with respect to the so-called parole waiver.

This action is predicated on the surety bond given by the respondents.

In that surety bond, the respondents agreed (R. p. 604) that no waiver or release by petitioner of any default or omission by the principal in complying with the building loan agreement or the plans and specifications would be binding upon the petitioner, unless such waiver or release should be in writing and signed by the duly authorized officers of the petitioner and specifically refer to the item or items specifically so released.

Who changed that agreement?

Respondents' counsel specifically state that that agreement was not changed. We quote from page 24 of their brief (italics ours):

> "Strictly speaking, the evidence excluded was offered to establish a waiver of strict performance *of the building loan agreement.*"

Mr. Justice CARDOZO, in *Beatty* v. *Guggenheim Exploration Co.*, 225 N. Y. 380, 388, referred to the law that

> "Whenever two men contract, no limitation self-imposed can destroy their power to contract again."

It is not claimed by anyone in this case that the surety bond or the above provision in the surety bond was ever

changed by anyone. Not only do respondents' counsel themselves say that the evidence offered was to establish waiver of the building loan agreement, but the fact is that *there is no claim that there is any scintilla of evidence that the respondents and petitioner ever talked together with respect to the provisions of this surety bond.*

Why, therefore, is not the above obligation of the respondents in their surety bond to the effect that no waiver or release shall be binding upon petitioner, unless (1) in writing; (2) signed by duly authorized officers, and (3) specifically referring to the items released, still in full force and effect today?

It follows from the plain, undisputed facts in this case that respondents, by their own agreement, which has in no way been changed, have estopped themselves from claiming any oral waiver or release.

It follows, therefore, that no parole evidence "tending to show" any waiver of the plans and specifications or consent to substitutions can possibly relieve the *respondents* from the provisions of their surety bond (which, as we have stated, even respondents' counsel admit have not been changed).

Respondents were paid for protection to petitioner against the uncertainties of the judicial determination of claims of waiver subsequent to the change, resting only on the conflicting oral testimony of interested parties. The bond was drafted so as to eliminate this stock defense of sureties; and there is no warrant for permitting its insertion in this case.

Another path leads to the same conclusion: Waiver proceeds on estoppel and must be predicated on a change of position by one of the parties based upon the conduct of the other.

Where can respondents point to any act of petitioner on which respondents relied to relieve respondents from that obligation in their surety bond, which specifically provides that no waiver or release shall be binding upon petitioner, unless (1) in writing, (2) signed by duly authorized officers of petitioner and (3) specifically referring to the items so released or waived?

We respectfully submit that this Court should not permit a holding to pass without review which prevents lenders from obtaining the very protection against a stock defense of surety companies (oral waiver), which the defendants were paid to give and be bound by in this case.

V

In Reply to Respondents' Point V

Aside from what we have stated in IV above, it is apparent that respondents have abandoned any attempt to show that the evidence, which the Circuit Court of Appeals has made the basis of the requirement of a new trial, in any way "tended to show" a waiver of any provision either of the bond or the building loan agreement.

The testimony which was excluded was objected to by petitioner as "irrelevant and not proper cross examination" (R. p. 213).

Respondents now argue that whether the particular question was relevant or not, they should be granted a new trial, in order to endeavor to produce some relevant testimony on that subject (see respondents' brief, p. 25). Such a contention is clearly untenable and is answered by the many cases which require an adequate offer of proof as a basis for reversal.

As a matter of fact, respondents were not "prevented from proceeding further", as stated on page 25 of their brief. On the contrary, respondents endeavored subsequently to show conversations between Haas (superintendent of the Lefcourt organization) and Walters (a former Lefcourt employee who was then serving as plaintiff's chief engineer), which conversations related only to alleged oral waivers of interior bathroom radiators (R. pp. 394-97), and that item was disallowed by the Court on other grounds (R. p. 514).

The fact that defendants were unable in the course of over 400 pages of testimony to suggest any evidence tending to show a waiver of any specific item included in the omissions or substitutions for which damages have been allowed demonstrates the futility of the new trial which the Circuit Court of Appeals has directed.

VI

In Reply to Respondents' Point VI

The contention by respondents that there must be a new trial because petitioner did not furnish, as such, *opinion evidence* showing the difference in value between the incompleted building on December 16, 1930 and the value of such building, if it had been completed up to the mark of the contract, is, as we have already shown, contrary to the holdings in the *Trainor* and *Kidd* cases. In other words, measure of damages can be complied with and met by many *kinds* of evidence and, as we have shown, the *kinds* of evidence which petitioner offered were within and complied with the *Trainor* and *Kidd* cases.

The fallacy of respondents' argument in this case is well shown by the statement at the foot of page 11 of their brief, to the effect that (italics ours)

> "the premises as they stood on the date of the default *might have been* of a value in excess of the amount of its" (petitioner's) "mortgage."

Not only does such a contention deprive a prudent lender of the margin of safety (equity) which should always be present in mortgage loans, and not only does such contention seek to substitute the judgment of someone other than the lender as to just how much margin of safety (equity) there should be, and not only does this contention make it imposible for a lender who advances less than 100% of the value of the land and building to receive any benefit from a surety bond, but also such a contention is directly contrary to the decision of this Court in *Trainor* v. *Aetna Casualty Co.*, 290 U. S. 47, where this Court specifically stated at page 53:

> "With that conclusion we are unable to agree."

LAST POINT

The petition for writ of certiorari should be granted.

Dated, September 20, 1935.

Respectfully submitted,

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